In the Supreme Court of the United States

OCTOBER TERM, 1955

FEDERAL POWER COMMISSION, *Petitioner,* vs. SIERRA PACIFIC POWER COMPANY,	No. 51
PACIFIC GAS AND ELECTRIC COMPANY, *Petitioner,* vs. SIERRA PACIFIC POWER COMPANY.	No. 53

Reply Brief for Petitioner Pacific Gas and Electric Company

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Page

I. The "Just and Reasonable" Standard Was Correctly Applied by the Commission in This Proceeding 2

A. The "Just and Reasonable" Standard Is a Commission Determined Standard 2

B. The Cost of Rendering Service, Including the Return to Investors, Is a Relevant Factor in Every Rate Determination Proceeding 5

C. The Willingness of a Utility to Accept a Rate Is Not Determinative of the Reasonableness of the Rate 7

D. The Commission Correctly Applied the "Just and Reasonable" Standard in This Proceeding 9

II. Respondent's Contentions as to the Procedure to Be Followed Are Erroneous 10

A. The Procedure of Section 205 Is a Reasonable Regulatory Process, by Which a Utility May Obtain a Change in a Contract Specified Rate, if Shown to Be Necessary to Make the Rate Just and Reasonable 11

B. Section 206(a) of the Act Does Not Authorize a Public Utility to Initiate a Rate Proceeding 13

C. No Considerations Advanced by Sierra Justify Its Contention That PG&E's Use of the Section 205 Procedure Was Unlawful 14

III. The Record and the Authorities Fully Establish that the Commission Made a Finding that the Old Rate Was Unreasonable and that This Finding Fully Supports the Commission's Order 15

IV. Sierra Has Failed to Show Adequate Reason Why the Proceeding Should Be Dismissed Even if a Further Formal Finding Was Required 17

Page

V. Sierra's Statements of Fact Are Misleading and Erroneous 17

A. Sierra's Repeated Statement that PG&E Entered into Contracts Tying Up All of the Bureau's Available Power Is Contrary to Fact 18

B. Sierra's Statement that PG&E Denied in Its Brief Before the Court of Appeals that it Entered into a Wheeling and Purchase Agreement Is Contrary to Fact 18

C. Sierra's Repeated Statement that PG&E First Attempted to Increase the Sierra Rate "After the Threat of Competition Had Been Removed" Is Contrary to Fact 19

D. Sierra Did Not Have Even the Hope of a Proposal to Obtain Bureau Power Through PG&E Wheeling 19

E. The Proposal for Construction of a Power Line Over the Sierra-Nevada Mountains to Supply Sierra with Power from Shasta Dam Could Not Have Met Sierra's Power Requirements 20

F. Sierra Fails to Produce Any Evidence to Contradict the Commission's Conclusion That PG&E Was the Only Feasible Source of Power to Supply Sierra's Requirements 22

G. Sierra's Argument About PG&E Motivation Is Plainly Invented 23

H. Sierra's Attack on the Commission's Conclusion that the Rate of Return Under the New Rate Is No Higher than the Rate of Return Anticipated Under the Contract Is Entirely Unwarranted 24

I. The Evidence Actually Shows that it was Understood that the Purpose of the Term of the Contract was to Protect PG&E's Investment 26

J. The Adoption of Schedule P-31 Charges Does Not Support Sierra's Contention that the Rate was to Be Fixed for the Contract Term 30

K. Sierra Did Not Negotiate on the Basis that an Alternative Source of Power was Actually Available 32

Conclusion 36

TABLE OF AUTHORITIES CITED

	Pages
Atlantic Coast Line R. Co. v. Florida, 295 U.S. 301 (1935)	15, 16
Arkansas Natural Gas Co. v. Railroad Commission, 261 U.S. 379 (1923)	6
Columbus R. Power and Light Co. v. Columbus, 249 U.S. 399 (1919)	6
Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944)	5, 7
In the Matter of Natural Gas Pipeline Company, F.P.C. Docket No. G-2302	3
In re Pacific Gas and Electric Co., 52 Ops. & Ord. Pub. Util. Comm. of Calif. 113; 96 PUR (NS) 493	19
Mobile Gas Corporation v. Federal Power Commission, 215 F. 2d 883 (1954)	11, 14
Railroad & Light Co. v. Court of Industrial Relations, 113 Kan. 217, 214 Pac. 797 (1923)	7
U. S. v. P. U. C., 345 U.S. 295 (1953)	10
Wichita R. R. v. Public Utilities Comm., 260 U.S. 48 (1922)	14

STATUTES

Federal Power Act, 49 Stat. 838, 16 U.S.C. 791a:	
Section 201	6
Section 205	2, 10, 11, 13, 14, 15, 17
Section 205(a)	5, 6
Section 205(d)	5, 12, 13
Section 205(e)	2, 12, 14
Section 206(a)	13, 15, 17
Section 206(c)	2
Federal Power Comm. Rule 35.3, Title 18, Code of Federal Regulations	11
Kans. Sess. Laws 1911, C. 238, Section 20	14

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Respondent's argument is based entirely upon erroneous views of the nature of the regulatory process under the Federal Power Act. In an attempt to bolster his position, Sierra's counsel has attached labels, such as "repudiation", which beg the question, and has tried to influence this Court through misstatements of fact and argument about equities which the Commission rejected, after full consideration, in favor of clear evidence to the contrary.

The decision of the Court below was based upon its interpretation of the Federal Power Act, and did not concern itself with the equities of the case. We take up, first, therefore, the legal aspects of the case, but would remind this

Court that under the Commission's interpretation of Section 205 of the Federal Power Act, it would be impossible for the cost of power to Sierra to be increased in excess of the amount determined by the Commission to be just and reasonable, and Sierra has not at any time paid any money in excess of the just and reasonable rate for the service rendered nor did the Court below find otherwise.

I. THE "JUST AND REASONABLE" STANDARD WAS CORRECTLY APPLIED BY THE COMMISSION IN THIS PROCEEDING.

A. The "Just and Reasonable" Standard is a Commission Determined Standard.

The basic principle of the Federal Power Act is that all rates must be just and reasonable, an ascertainable standard which is to be precisely applied by the Commission. In no case does the Commission's standard yield to a determination by the utility, either acting alone or in concert with a contracting party, that some other rate is reasonable. That the utility's determination might fall within the judicially permissive area for Commission action is immaterial. The "area" results from the limitation on the judicial application of the "just and reasonable" standard. The standard itself is precise and is to be applied by the Commission to all rates, not merely to rates which fail to meet the test of the judicial power.

Realizing that recognition of these principles would destroy the foundation of the decision of the Court below, Sierra is compelled to assert that the Commission can apply only an "area" standard to measure the reasonableness of the utility's filed rate.[1] If this is so, the Commission is required to accept a rate which is not consistent with the

1. In a Section 205(e) hearing, the filed rate would be the new rate proposed by the utility, and, in a Section 206(e) hearing, the filed rate would be the existing rate.

Commission's definite standard of reasonableness, a result certainly not intended by Congress. In actual practice, the Commission has accepted no such limitation on its powers.

At one place Sierra says that the Commission's "duty in reviewing that rate (i.e. a filed rate) is the same as that of a court sitting to review a rate fixed by the commission".[2a] Elsewhere Sierra says that it is obvious that the Commission's test is "quite different" from that of a court.[2b] The latter statement is of course true. The Commission's test is precise.[2c] Sierra cites no authority in support of its contention for an "area" limitation upon the Commission, whether or not equivalent to an "area" concept of the court.

The astonishing nature of Sierra's contention is demonstrated by the fact that its alleged "zone" would have encompassed two such widely different rates. The old rate

2. A recent example is *In the Matter of Natural Gas Pipeline Company*, decided by the Commission April 1, 1955, (F.P.C. Docket No. G-2302, reported in Commerce Clearing House Utilities Law Reporter (Federal) at paragraph 9459) where the Commission's examiner passed upon a rate filing which he found was expected to produce a rate of return of 6.1%. The examiner approved the filing and rejected a contention that the filing should be found unreasonable because in a prior proceeding the Commission had approved only a 6% return for this Company. In the examiner's view, the difference between the rate proposed and the slightly lower rate, which would be sufficient to produce a 6% rate was minor, approached the realm of the infinitesimal, and was "de minimis", and he stated that reasonableness is established by a zone rather than a fixed point. The Commission, however, rejected the examiner's conclusion and reduced the rates to yield only 6%. The Commission observed that although "a difference so slight does not in and of itself represent the difference between a fair and unfair rate of return", the return "must be fixed, in the final analysis, upon the Commission's best judgment of what is fair, considering the evidence of record and guided by the basic facts required by law to be considered." Since the examiner's decision cited evidence upon which a rate of return in excess of 6.1% was affirmatively justified, there can be no doubt that the Commission was applying its own expert judgment and was not exercising merely the review functions of a Court.

2a. Respondent's Brief p. 36.

2b. Respondent's Brief p. 35.

2c. See the citations at pp. 19 and 23 of PG&E's Opening Brief

produces only 78% of the revenue which the Commission found reasonable under the new rate.[2d] The difference in net return is even greater since the old rate produces only 55% of the return allowed by the Commission under the new rate.[2e]

It should also be pointed out that Sierra's views of the Commission's authority in rate proceedings, like that of the Court below, necessarily extends not only to contract-specified rates, but to all rates. Were such views to prevail, a utility which had a rate within the permitted area would be entitled to continue it in effect even though the Commission concluded that a lower rate was reasonable for the service rendered. However, if the utility's rate just barely exceeded the permitted bounds, its charges would be reduced to the level found by the Commission to be reasonable. The utility, however, would then be able to attempt to place an increase in effect which would fall just slightly below the upper limit. By a process of trial and error, a utility could attempt to keep its rates close to the upper limit of the zone, thus completely nullifying the Commission's expert and precise determination of the reasonable rate.

It is no wonder that Sierra concludes that its position would not handicap the Commission; it believes that the Commission is hamstrung to begin with. Our statement that the acceptance of this position by the Court below impairs the Commission's effectiveness is fully confirmed. We submit that Sierra's argument is entirely without foundation in statute, case authority, or practical experience, and would deprive the public of the benefit of regulation by an expert and especially informed agency, as intended by Congress.

This is the crux of the case. If the Commission's standards are controlling, there is no occasion to read into Section

2d. Derived from data at R. 137.

2e. Derived from data at R. 295.

205(d) a special rule for contract-specified rates. Whatever the utility may file, the Commission's standard will determine the outcome.

B. The Cost of Rendering Service, Including the Return to Investors, Is a Relevant Factor in Every Rate Determination Proceeding.

Congress has by Section 205(a) declared that the public interest requires all rates for public utility service to be just and reasonable. This Court said in the *Hope* case:[3] "The rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates involves a balancing of the investor and consumer interests." The Court then points out that this requires that revenues cover not only operating expenses, but also capital costs.

This concern for the investor interest is more than a matter of the rights of investors as individuals, important as these rights are. Each utility enterprise must recover its costs including cost of capital through its rates or not at all. If those rates do not cover a fair return to investors the added risk will increase the cost of capital and rapidly affect the costs to all of the consumers of the utility. The return from any part of the enterprise cannot be insulated from the business as a whole. Its effect does not depend on whether the utility is on the verge of bankruptcy or in danger of having to abandon service.

In the case at hand, PG&E is obliged to place in service an additional 110,000 volt transmission line to meet Sierra's expanding load,[4] and, of course, will also have to add the necessary generating capacity for this purpose. The capital for these facilities could not possibly be raised on the basis

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3. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 at 603 (1944).

4. PG&E's obligation to do so under the 1948 contract is stated at R. 143-144. Construction of the line was initiated this year at an estimated cost in excess of $1,000,000.

of revenue from the 1948 contract-specified rates, yielding only 2.6% return.[5] It can be raised only on the general credit of PG&E. Is it not in the public interest, then, that Sierra pay its just and reasonable share in the maintenance of that credit?

Sierra answers "No" and insists that the "profitableness" of a contract-specified rate is irrelevant as a matter of law, unless the public interest is affected.[6] The "unless" clause of Sierra's statement actually destroys the value of Sierra's argument.

Congress has already determined that the public interest requires that all rates shall be just and reasonable. In Section 201 of the Federal Power Act Congress declared that "federal regulation * * * of that part of such business which consists of * * * the sale of such energy at wholesale in interstate commerce is necessary in the public interest * * *". In Section 205 (a) Congress required that "all rates and charges * * * for the sale of electric energy subject to the jurisdiction of the Commission * * * shall be just and reasonable and any such rate or charge that is not just and reasonable is hereby declared to be unlawful".

Thus when Sierra concedes that the public interest must be consulted it concedes that the issue is whether the rate is just and reasonable. This test, of course, is to be applied by the Commission, and the Courts cannot "as a matter of law" foreclose the Commission from determining whether the reasonableness is affected by the return.

Sierra attempts to support its position by citing three cases. One, *Columbus R. Power and Light Co. v. Columbus*, 249 U.S. 399 (1919) deals solely with the equity power of a Court and may be dismissed from further consideration. Another, *Arkansas Natural Gas Co. v. Railroad Com-*

5. R. 295.

6. Respondent's Brief p. 41.

mission, 261 U.S. 379 (1923), dealt with a state commission order under a statute which expressly denied it the power to alter contracts. The case of *Railroad & Light Co. v. Court of Industrial Relations*, 113 Kan. 217, 214 Pac. 797 (1923), was *dictum* in the course of affirming trial Court proceedings which constituted trials *de novo*. Furthermore, the reasoning of these Courts cannot be applied to rates regulated by the Federal Power Commission in the light of the *Hope* case.

C. The Willingness of a Utility to Accept a Rate Is Not Determinative of the Reasonableness of the Rate.

Underlying much of Sierra argument seems to be an implied assumption that Commission must accept a nondiscriminatory rate yielding less than a normal reasonable rate of return, if the utility proposes it. Such an assumption is unjustified.

A proposed rate which yields a return to the utility below that to which it is entitled on its business as a whole may be reasonable because of other circumstances, but it is not reasonable simply because the management of the utility is willing to accept the lesser return. The Commission is no more bound to accept as reasonable a rate yielding 4¾% than a rate yielding 6¾%, merely because the utility has proposed it. Respondent's counsel qualifies his assertion by admitting that the Commission need not accept the utility proposed rate if it amounts to an undue preference or is discriminatory, but he ignores additional factors which must be considered by the Commission such as its concern for the financial health of the utility to the end that service to all customers will be maintained at a reasonable cost, and its obligation to see that the interests of investors in the utility are protected, since these interests constitute a part of the

public interest which the Commission must take into account.

As a practical matter, of course, the Commission properly directs its immediate attention to whether the yield from a particular rate is too high, rather than whether it is too low. In the absence of circumstances which indicate otherwise the Commission may reasonably feel that the management of a utility will request as high a rate as can be justified under all the circumstances. These practical aspects, however, do not weaken the proposition that reasonableness is not a matter of what the utility is willing to accept, but is a matter which must be justified by balancing all of the public interests involved.

In filing a rate, the utility represents that its proposal constitutes the just and reasonable rate for the service to be rendered. If the utility subsequently files a higher rate and there has been no change in conditions, the Commission might give weight to the original representation and consequently question the new filing. The Commission would not, however, be bound in any way by the utility's representations.

Thus, the proposal of a particular rate may be evidence as to its reasonableness, but it cannot be conclusive. This disposes of Sierra's contention that because the Commission found reasonable a 4.75% (which is less than the 5.5% stipulated to be reasonable for PG&E's electric operations generally) return it must also find reasonable a 2.6% return (which is also less than 5.5%).[7] Such an obvious *non sequitur* cannot gain any force from the fact that PG&E was willing to accept the 4.75% return. It has not expressed any willingness to accept a lesser return from the Sierra business.

7. Respondent's Brief p. 46.

D. The Commission Correctly Applied the "Just and Reasonable" Standard in This Proceeding.

Actually, Sierra does not contend that the Commission erred in finding that the increased rate was reasonable. This is because Sierra is committed to the proposition that both rates are reasonable.[7a] Consequently, Sierra's attention is directed to whether the 1948 contract-specified rate is still reasonable in 1955. It answers the Commission with only two propositions.[8]

The first proposition is that the rate of return or "profitableness" of the Sierra rate is immaterial as a matter of law. This point we have already answered.

The second proposition is that the contract-specified rate represents "the minimum PG&E is willing to accept." This, of course, is absurd on its face, in the light of PG&E's request for a higher rate, unless Sierra's point is translated into the proposition that, having made a contract in 1948, PG&E is required to accept that rate whether it wants to or not. This point we have answered by showing that acceptance by the utility is not controlling in any event. Further mention should be made, however, of the application of this principle to the facts of the present case.

Sierra's second proposition is obviously only another form of its contention that PG&E contracted for a fixed rate for a term which it now appears will run 23 years. Although Sierra professes to concede that a contract rate may be changed by the regulatory process, its position seems to be that PG&E made a contract which must be applied as though that regulatory process did not exist, except for the benefit of Sierra.

The existence of a contract does not in any way determine the reasonableness of the rate or limit the Commission's power to determine that a different rate should be charged.

7a. Respondent's Brief, p. 47.

8. Respondent's Brief pp. 40 to 47.

The possibility of change in a public utility service contract in accordance with the law in effect at the time the contract is made must be within the reasonable expectations of the contracting parties, especially when both of the parties are public utilities and familiar with the regulatory processes. In the present case, there is no doubt that this possibility was present in the minds of PG&E and Sierra for they expressly provided in the 1948 contract that it was subject to change by the California Public Utilities Commission.[9] It also should be noted that when Sierra's management was emphasizing the advantages of the contract in testimony before the California Public Utilities Commission,[10] it did not claim that this contract had the unusual feature of creating a ceiling price, regardless of the cost of service to PG&E. We go into further detail on the evidence as to the expectation of the parties. *Infra*, subhead I, Point V.

Sierra does not relate the remainder of its arguiment on the facts to the issue of reasonableness and we will take them up later in this reply.

II. RESPONDENT'S CONTENTIONS AS TO THE PROCEDURE TO BE FOLLOWED ARE ERRONEOUS.

PG&E initiated this proceeding in order to change a contract-specified rate by the regulatory process established in Section 205 of the Federal Power Act. Sierra chooses to describe these same facts as a repudiation of a solemn agreement. This, of course, begs the question as to the scope and effect of the contract, and the right of a party to follow a specific statutory procedure. Elsewhere, Sierra characterizes the use of this process as unilateral abrogation of a

9. R. 145, para. 12. At the time the contract was made, it was thought that it was subject to the jurisdiction of both the California Commission and Federal Power Commission. Since the decision in *U.S. v. P.U.C.*, 345 U.S. 295 (1953), it seems clear that all sales under the contract are subject exclusively to federal jurisdiction.

10. Cf. Respondent's brief pp. 58 and 59.

contract, and claims that the use of this process would permit a utility to determine when the public interest requires a utility service contract to be set aside.[11] These characterizations are a complete misdescription of the process.

A. The Procedure of Section 205 Is a Reasonable Regulatory Process, by Which a Utility May Obtain a Change in a Contract-Specified Rate, if Shown to Be Necessary to Make the Rate Just and Reasonable.

The filing of a new schedule for the purpose of changing an existing rate is only the first step of a rational and constitutional regulatory process. It is not, as Sierra would have it, the mere lodging of a notice for the purpose of giving due publicity.

In the first place, the schedule is filed, not with a mere publishing agency, like the Federal Register, but with a regulatory commission. This Commission has (1) in its members and in its staff both experience and expert knowledge, (2) general information in usable form about the filing utility, as a consequence of the imposition of a uniform system of accounts and the requirement of voluminous and detailed annual reports, (3) specific information[12] about the relation of the new schedule to the old schedule and other schedules for similar service, and (4) where an increase in rates is involved, specific information[12] about the cost of rendering service.

In the second place, the Commission upon its own initiative or upon complaint may order a hearing upon the reasonableness of the filed schedule. The Commission need not, and customarily does not, support its order for a hearing with any justification other than the bare statement that the proposed rate may be unjust or unreasonable.

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11. Respondent's brief, *Mobile* case, p. 24.

12. See Commission Rule 35.3, Title 18, Code of Federal Regulations.

In the third place, indicating the tentative nature of a new filing, the burden of proof is placed squarely on the utility to justify any increase sought.

In the fourth place, at the conclusion of the hearing, the Commission may fix whatever rate it, in its expert judgment, deems to be the just and reasonable rate on the basis of the evidence submitted, without regard to either the existing rate or the rate proposed by the utility.

The foregoing is obviously a description of a full fledged regulatory process. This Court has had ample opportunity to observe the vigilance and zeal with which the Federal Power Commission carries out its duties under this procedure and requires the utility to prove to the hilt its justification for a rate increase. A review of the record in this case will indicate that in receiving evidence and considering all possible aspects of the case, the Commission adhered to the high standard it has consistently applied.

Sierra, however, by assuming that the filed rate procedure consists of a bare notice to the Commission has characterized it as a procedure permitting the utility to change a contract-specified rate at will. Without this assumption, the whole argument against the use of Sections 205(d) and (e) to change contract-specified rates loses all validity.

It remains true that under Sections 205(d) and (e) an increase in a contract-specified rate may be filed by the utility and, in the absence of question by the Commission or complaint by the customer, may become effective. This is no more to be deplored than the granting of a judgment in a civil proceeding without a court hearing where there is no contest of the granting of *ex parte* relief in equity proceedings upon the affidavit of one party. In fact, because of the position of the Commission as an expert body and its special information, there is complete assurance that the public interest will be protected even in uncontested cases.

The filing of a schedule, together with the justification which the Commission requires, constitutes, in actual practice the substantial equivalent of an application under other procedures for authority to increase rates. Sierra would label the right to make such a filing "authority to a public utility to abrogate its own contract unilaterally."[13] Accurately, it is the right to initiate a rate change in accordance with law. Regardless of the label, there is no question but that the utility has no right to place in effect (except subject to refund) any rate except the just and reasonable rate for the service to be rendered.

Sierra professes to find difficulty in our interpretation of Section 205(d), but there should be no problem. If contracts could not be changed by filing schedules there would be no reason for this section to provide that the filing must precede the change by at least 30 days.

B. Section 206(a) of the Act Does Not Authorize a Public Utility to Initiate a Rate Proceeding.

We have pointed out that Section 206(a) grants to the Commission and to complaining parties the right to initiate a rate proceeding without proposing a new rate, but that a utility which desires a rate change must proceed under Section 205 to propose a new rate and justify its reasonableness.

Respondent seems to acquiesce in the proposition that the Section 206(a) procedure is not available to the utility. Its denial to the utility of a right to initiate a proceeding under Section 205 would make the Federal Power Act completely one-sided with respect to contract-specified rates. Unquestionably, the customer party to a contract may institute a rate proceeding whenever it believes that the utility's costs

13. Respondent's Brief p. 30.

have decreased, or that other circumstances have arisen, so that the contract-specified rate is no longer just and reasonable. The logical and reasonable interpretation of the Act would give the utility the corresponding privilege under Section 205, whenever it believed that increases in cost, or other factors, made the old contract-specified rate unreasonable.

C. No Considerations Advanced by Sierra Justify Its Contention That PG&E's Use of the Section 205 Procedure Was Unlawful.

We have already pointed out the irrational nature of Sierra's contention that there is more than one reasonable rate which the Commission must accept in a rate proceeding. A rational view of the Commission's powers clearly requires that the result be the same under either procedure and no considerations of substance need enter into the choice between them.

Sierra does not dispute that the interim collection procedure of Section 205(e) equitably minimizes the burden of regulatory delay.

Sierra's argument that Section 205 is like the rate filing procedure of Section 20 of the Kansas Act, involved in the Wichita Case, because Section 205 (e) does not provide for a hearing on the reasonableness of the contract-specified rate misses the point.[13a] Section 20 did not provide for any hearing at all whereas Section 205 (e) provides for a hearing which encompasses all relevant issues.

We assume that the reply brief for the Federal Power Commission will deal with the discussion of cases by the Respondent in the *Mobile* case and the unwarranted characterizations there made and we deem it unnecessary to discuss them further here.

13a. Repondent's Brief in the *Mobile* Case, p. 35.

III. THE RECORD AND THE AUTHORITIES FULLY ESTABLISH THAT THE COMMISSION MADE A FINDING THAT THE OLD RATE WAS UNREASONABLE AND THAT THIS FINDING FULLY SUPPORTS THE COMMISSION'S ORDER.

Sierra, of course, had to concede by silence that (1) the issue of reasonableness of the old rate was directly presented to the Commission by proposed findings of PG&E and Sierra, (2) all evidence material to Sierra's contention on this issue was received, and (3) the Commission's conclusion of unreasonableness was expressly incorporated in the formal findings.

Nevertheless, Sierra makes the bald statement that the finding was not made. Nothing that Sierra says justifies this conclusion and it cannot be doubted that the Commission made this finding to avoid the necessity for further proceedings in the unlikely event that its view of the procedure was rejected.

Sierra makes more of an argument to the effect that the Commission's finding cannot validate the rate increase during the nine months' period from September 6, 1953 (when the suspension terminated) to June 17, 1954 (the date of the Commission's decision). It seems fair to conclude then, that the finding would, in Sierra's view, support the rate increase after June 17, 1954, except for the hypertechnical argument that the proceeding has been styled one under Section 205, instead of Section 206(a). In arguing that the rate increase could not be validated for any period preceding the date when the Commission supplied the necessary finding, Sierra ignores *Atlantic Coast Line R. Co. v. Florida*, 295 U.S. 301 (1935), which we cited in our brief.

In that case, increased freight charges were collected by a railroad in accordance with an order of the Interstate Commerce Commission. This order was set aside on the ground that the findings of the Commisison were incomplete and inadequate. Still later, the Commission upon new evi-

dence and adequate findings, made the same order it had before. Certain shippers sought restitution of the increase in rates collected while the first, invalid, order was in force. This Court held that no restitution should be granted. Much of what was there said by Justice Cardozo is applicable here, but we confine our quotation to his description of the reasoning of the Court:

> "* * * All that the federal court does is to announce that it will stand aloof. It inquires whether anything has happened whereby a court of equity would be moved to impose equitable conditions upon equitable relief. In the course of that inquiry it perceives that the charges were collected under color of legal right, in circumstances relieving the carrier of any stigma of extortion. It discovers through the evidence submitted to the Commission and renewed in the present record that what was charged would have been lawful as well as fair if there had been no blunders of procedure, no administrative delays. Learning those things, it says no more than this, that irrespective of legal rights and remedies it will not intervene affirmatively, in the exercise of its equitable and discretionary powers, to change the status quo." (295 U.S. 315)

The parallel with the present case is clear. In both cases a finding claimed to be necessary was not made before the collection period started. In both, the finding, when made, established the reasonableness of the amount collected and the unreasonableness of the low rate for the entire collection period. For the reasons advanced by Justice Cardozo, it is clear that the Commission should be affirmed even if it was in error procedurally.

We have already dealt with Sierra's contention[15b] that the Commission erred in finding the old rate unreasonable. Refer to subhead D of Point I, supra.

15b. Respondent's Brief, subhead C, Point III, pp. 40-47.

IV. SIERRA HAS FAILED TO SHOW ADEQUATE REASON WHY THE PROCEEDING SHOULD BE DISMISSED EVEN IF A FURTHER FORMAL FINDING WAS REQUIRED.

Sierra concedes that it should be unnecessary to duplicate the prior hearing on this matter and is now willing to have the order of the Court below amended to instruct the Commission "to dismiss the proceeding under Section 205 without prejudice to the continuation of further proceedings under Section 206(a)".[14] This ingenious "dismissal with continuation" is proposed for the purpose of avoiding the possibility of a *nunc pro tunc* order of the Commission, supplying in even more formal terms the finding which has already been made. It is simply an attempt to interpose a technical obstacle to the retention by PG&E of a rate established as the just and reasonable rate for the service rendered.

We would point out also that Sierra does not contest the principle that if there were a mistake of law, the sole function of the Court below is to send the case back for further proceedings to correct the error.[14a]

V. SIERRA'S STATEMENTS OF FACT ARE MISLEADING AND ERRONEOUS.

Finding that many of its arguments are irrelevant to the issue of reasonableness of the rate Sierra has incorporated a miscellany of items in its statements of fact and in a point which refers vaguely to abuse of administrative discretion.[15]

These contentions are based on statements of fact which are sometimes totally erroneous and sometimes simply misleading. We take up what seem to us the more important errors.

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14. Respondent's Brief, p. 32, footnote 10.

14a. PG&E Brief, p. 38.

15. Respondent's Brief, p. 50.

A. Sierra's Repeated Statement That PG&E Entered Into Contracts Tying Up All of the Bureau's Available Power is Contrary to Fact.[16]

There is no evidence whatever to justify this statement. PG&E agreed, in April 1951, to "wheel" power for the Bureau. PG&E purchases no power under this agreement. In October 1954 PG&E made an agreement to purchase from the Bureau power in excess of that which the Bureau wished to sell to any customer. PG&E obviously tied up nothing by these contracts.

These contracts are not in evidence and there is no competent description of their terms in the record. We are compelled to go outside of the record because of Sierra's unjustified charges, which have no evidentiary support.

B. Sierra's Statement That PG&E Denied in its Brief before the Court of Appeals That It Entered Into a Wheeling and Purchase Agreement is Contrary to Fact.[17]

This is not at all what we denied. Sierra's reference is to our denial of an entirely different proposition. We actually said:

> "Sierra attempts to impute bad faith to PG&E on the ground that it has sought an increased rate because it has made Shasta Dam power unavailable to Sierra. The imputation is false. Although it is true that PG&E purchases all the power from Shasta Dam not otherwise disposed of by the Bureau of Reclamation, it is also true that the Bureau has no continuing obligation to sell such power to PG&E and may sell to any customer it chooses. There is no testimony to the contrary in this record and this Court should be advised that such is the actual fact."[17a]

16. Respondent's Brief, pp. 52 and 61.

17. Respondent's Brief, p. 9, note 6.

17a. Brief for Intervenor PG&E in U. S. Court of Appeals for District of Columbia, p. 33.

Our statement is still true. Sierra attempted to answer it by referring to a telephone conversation which showed that the Bureau had made a contract in 1952 to sell 290,000 kilowatts of power to the Sacramento Municipal Utility District. This demonstrated that it was the Bureau which tied up its power, not PG&E.

C. Sierra's Repeated Statement That PG&E First Attempted to Increase the Sierra Rate "After the Threat of Competition Had Been Removed" is Contrary to Fact.[18]

The fact is that PG&E filed its specific proposal for an increase in the Sierra rate in October 1951,[19] some 14 months before December 1952 when the Bureau made the 290,000 kilowatts contract above referred to.

When the events are considered in the order in which they occurred it is clear that PG&E initiated the increase in contract specified rates simply for the purpose of meeting increased costs and that the filing was made after the PG&E had agreed to provide facilities by which most of the contract customers could actually obtain power from the Bureau.

D. Sierra Did Not Have Even the Hope of a Proposal to Obtain Bureau Power Through PG&E Wheeling.

One of the two alternatives which Sierra claims to have been responsible for the rate of the 1948 contract is a proposal for "wheeling" Bureau power over PG&E lines to Nevada.

It would indeed be amazing if PG&E should turn out to have been willing to supply the means by which the Bureau

18. Respondent's Brief, pp. 9-10; see also pp. 52 and 55.

19. See *In re Pacific Gas and Electric Co.*, 52 Ops. & Ord. Pub. Util. Comm. of Calif. 113; 96 PUR (NS) 493.

of Reclamation could take over the Sierra business. The fact of the matter is that Sierra cannot show that it ever considered it possible that PG&E would wheel Bureau power. Certainly, Sierra's president would have been dishonest if he had thought that wheeling was a competitive possibility and yet testified in 1948 that the reason Bureau power could not be considered was that it would take too long to get a Congressional appropriation and build the required transmission line. That he was honest in that is borne out by the statement of Sierra's counsel at the same hearing that wheeling was "utterly impossible".[20] In fact, it did not even occur to the present counsel for Sierra to argue the wheeling possibility in his original brief in 1953 to the Federal Power Commission.

To support its charge of self-competition by PG&E, counsel for Sierra points to the fact that the Bureau asked PG&E to wheel to Nevada and that PG&E studied the cost and revenue implications of such a proposal. It is abundantly clear, however, that PG&E was not willing to "wheel" to Sierra for the Bureau's benefit. In fact, PG&E maintained the same position when it finally agreed to wheel power for the Bureau in the Central Valley region of California. PG&E could not now be said to have deprived Sierra of an opportunity to obtain power by wheeling when Sierra never had such an opportunity in the first place.

E. The Proposal for Construction of a Power Line Over the Sierra-Nevada Mountains to Supply Sierra with Power from Shasta Dam Could Not Have Met Sierra's Power Requirements.

The proposal of the Bureau to construct a power line was a mere possibility, depending upon obtaining an appropriation from Congress. Admittedly, the line could not have

20 R. 242.

been completed in time to meet Sierra's requirements. Counsel for Sierra attempted to meet this defect in his argument to the Federal Power Commission by asserting that Sierra could have developed additional plants "to tide over the expected shortages until the Bureau's lines could be completed."[21] This statement was made in the face of testimony by Sierra's president that construction of the plants would have taken a minimum of three years.[22] The absurdity of making an investment in generating plants for the purpose of "tiding over" a brief span of years is manifest.

In arguing to this Court, counsel now prefers to assume that Sierra would simply refuse to supply the additional power needed in its area. Although Sierra's rate engineer mentioned such a refusal in his testimony given in 1953, it is plain that no one in 1947 or 1948 proposed or considered such a course, which would constitute failure by Sierra to live up to its public-utility obligations.[23] Least of all, do we think that Nevada Public Service Commission would have permitted such a situation to arise, even though in 1953 it said that it might have ordered construction of additional plants in 1948.

Uncertainty as to the obtaining of an appropriation and the certainty of delay were not the only defects in the Bureau's proposal to construct a transmission line. Sierra's president testified that he would not rely upon a single hydroelectric generating source and a single transmission line as a source of supply. He said that standby service from another source would be necessary "to assure anywheres near reasonable service", and that the cost of such standby

21. Sierra's opening Brief before the Federal Power Commission, p. 66. See also p. 39.

22. R 217.

23. See Sierra's recognition in 1948 of its obligation to serve. R 209.

would mean "prohibitive" total cost for the necessary service.[24]

F. Sierra Fails to Produce Any Evidence to Contradict the Commission's Conclusion That PG&E Was the Only Feasible Source of Power to Supply Sierra's Requirements.

The Commission states:

> "Second, we find Sierra's argument that it has foregone other sources of supply in reliance upon the continuance of all terms of the 1948 agreement unconvincing in the light of the record which clearly shows that in 1948 Sierra regarded the other sources of supply as being so unacceptable that PG&E became, in fact, the only feasible source."[25]

In all of the seven pages of argument with which Sierra attempts to refute the foregoing statement there is no reference to any evidence whatever which denies that "in 1948 Sierra regarded the other sources of supply as being so unacceptable that PG&E became, in fact, the only feasible source." Sierra has a good deal to say about PG&E's alleged motives, and it has nothing to say about Sierra's motives which would seem to be the actual subject of the proposition. Since the testimony on behalf of Sierra is so unequivocally clear that it did not want Bureau power, even at bargain prices, counsel for Sierra is obliged to brush it aside on the ground that the statements emphasized only part of the facts and in effect were mere self-serving declarations.[26] The fact of the matter is that Sierra's officers knew as well as anybody that they could not get power from the Bureau, either by wheeling or by construction of a power line, in time to meet their needs. Nor, as we have already

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24. R. 208-209, 213.

25. R. 451.

26. Respondent's Brief, pp. 58 and 59.

pointed out, could construction of a plant by Sierra have been completed in time to meet its needs.

G. Sierra's Argument About PG&E Motivation Is Plainly Invented.

Sierra's argument is based entirely on the proposition that because PG&E for its own internal purposes made a study of cost and revenue combinations in connection with the Bureau's unaccepted wheeling proposal, the Commission should therefore have disregarded everything else in the record.

It is absurd, of course, to think that the cost of service can be changed by making a different kind of cost study. Only counsel for Sierra would have the imagination to argue as though the cost of service to Sierra depended upon what figures Mr. B. B. Beckett or anybody else wrote down in a cost study.

What counsel for Sierra ignores and should in fairness have advised this Court is that PG&E made a detailed cost study some months previously and developed the amount by which service to Sierra at the rate then proposed by PG&E would fall short of producing a 6% return. This was a cost study based on the actual fact that Sierra was supplied from PG&E's integrated system. Mr. Beckett's study was based on the hypothesis that only Shasta power was used to supply Sierra, and consequently his study produced a purely hypothetical result. The Commission was therefore quite justified when it said:

> "Furthermore there is no warrant for the Commission to adopt a method of determining cost of serving a particular customer from an integrated electric power supply system which considers only the cost of energy from a single source of power on that system."[27]

27. R. 155, note 10.

That Sierra would have agreed with the Commission in 1948 is shown by the fact that Sierra's president then testified before the California Public Utilities Commission that his company was relying on the 75 diversified generating plants connected to PG&E's system and not on any single source of power.[28] A witness for PG&E in the same proceeding testified that Shasta power would be part of PG&E's power pool and that some Shasta power would undoubtedly find its way to Sierra but no one could say how much.[29]

Further, it is clear that the hypothetical costs under a wheeling arrangement were not the basis for fixing the rate which was offered Sierra. The rate to Sierra was substantially in excess of those hypothetical costs and would obviously have produced a return materially in excess of the 6% on the capital there assumed.

H. Sierra's Attack on the Commission's Conclusion That the Rate of Return Under the New Rate Is No Higher Than the Rate of Return Anticipated Under the Contract Is Entirely Unwarranted.

If the rate of return under the new rate for Sierra does not exceed the rate of return which was anticipated under the old rate it is clear that the increase in rate is equivalent to the increase in costs over those anticipated. The Commission's inquiry to the parties asking what rate of return was foreseen or reasonably foreseeable by PG&E at the time it made the contract was evidently intended to develop whether this equivalence between the increase in the rate and the increase in costs actually existed. Consequently, in endeavoring to answer the Commission's inquiry PG&E referred to the study of actual costs to serve Sierra from

28. R. 210.
29. R. 203.

its integrated system.[29a] As we have said, this cost study found the actual cost of serving Sierra on the basis of a 6% rate of return. This cost was compared with revenues under the then proposed rate to find the deficiency in revenue below cost of service. There is no doubt that the amount by which this deficiency would be increased by reason of the reduction in revenue due to proposal of the P-31 rate was a simple matter to determine and was known to PG&E management at the time of the final negotiations. The Commission rightly rejected on the basis of common sense Sierra's attempted inference that Mr. Beckett's hypothetical study was the sole information on which PG&E acted.

In order to show what PG&E's actual cost study meant in terms of rate of return, as requested by the Commission, it was a simple matter to relate these cost figures to the appropriate amount of capital. In brief, PG&E not having an "actually foreseen" rate of return presented the cost figures that were actually known so as to show the "reasonably foreseeable" rate of return.

Contrast with this the study which Sierra would have this Court believe is the answer to the Commission's question. In the first place, it does not develop a rate of return, and no one can tell from the figures in its study what rate of return was foreseeable under the P-31 rate proposal. We can say with certainty that it must have been more than 6% because the revenue exceeds the cost with return assumed at 6%.

Sierra unsuccessfully tried to persuade the Commission to accept a study which was based upon a purely hypothetical allocation of Shasta power, a study which did not even give an answer to the question which the Commission asked. On the other hand, PG&E's study was based upon actual cost estimates from which it was possible to develop

29a. See testimony of Mr. John F. Roberts, R. 67 *et seq.*

on a rational basis the reasonably foreseeable rate of return. The PG&E study, which occupies pages 356 to 408 of the Record, makes clear the source of the figures and the manner in which they were developed. The Commission's acceptance of their soundness was fully justified.

In view of all the argument by Sierra over this matter of cost studies it might be supposed that Sierra thought that the hypothetical wheeling cost study would show that the 1948 contract specified rate was still reasonable in 1952. As a matter of fact, even by this test the Commission showed that the contract specified rate was unreasonable.[30] Sierra fails to comment on this.

I. The Evidence Actually Shows That It Was Understood That the Purpose of the Term of the Contract Was to Protect PG&E's Investment.

The direct and positive evidence of the contract itself and the virtually contemporaneous statements in the 1948 hearing before the California Commission prove that the purpose of the 15-year term was protection of the new investment in a 100,000 volt transmission line.

Two prior contracts, each of which called for a new transmission line, had 15-year terms. PG&E's first proposal to Sierra in 1947 was for a new line and a new 15-year term. The 15 years was accepted without discussion throughout the negotiations and without relation to the rate.

It is significant that the contract relates the 15-year term to the completion of the new 110,000 volt line and requires a new 15-year term to begin when a second such line is completed and placed in operation to meet Sierra's requirements.

When to this internal evidence of the contract is added the statements of both parties made before the present

30. R. 455.

controversy arose there can be no doubt that the term of the contract was intended to protect their respective investments. As to the reason for the 15-year term, Mr. Pollard testified for PG&E before the California Commission in 1948:

> "Well, of course, that was—on our part was in order to guarantee that we would have business for a long enough period of time *to warrant us in making the investment* in the cost of the new line and amortizing it. And, furthermore, followed the same pattern as previous contracts we have had in each of which instances a substantial investment was made for service of this customer. And, similarly, 15-year contracts were taken at each of those times for that reason."[31]

In the same proceeding Sierra's president testified on the necessity for a 15-year contract as follows:

> "When load conditions are such that you have to have additional capacity it might be that that additional capacity could be arranged to carry you over for a short period—be sufficient to carry you over for a short period, but in case where you have to go to a relatively large investment it is only fair and business—proper business that the Company you are negotiating with *gets a proper return on the investment for that period.* That is the basis upon which we would operate ourselves, we would not expect anybody to go to a large investment which is necessary in order to give the Company capacity they need for any shorter period than that."[32]

In cross-examination, Sierra's president further said:

> "Q. This contract effectively ties Sierra's hands for 15 years, will it not?
>
> A. In what way do you mean?

31. R. 200, emphasis supplied.

32. R. 207, emphasis supplied.

Q. Well, because of the fact that you are prohibited from developing any further power facilities of your own?

A. No, I do not think that is true. The contract is worded in that way, if the parties have a modification that is justified I think the parties can get together on it. In other words, only the, the principal thing that the selling party would have—I might be corrected on this if I am wrong from P.G.&E. Company—would be idle investment. In other words, if we had a development that we found feasible and it came in at a time when any investment was [not][33] made idle by the P.G.&E. in other words, at a time when they might have to put in additional investment even to serve it, it would not penalize P.G.&E. if we went ahead on it and we could make arrangements with them to do so."[34]

In other words, Sierra believed that PG&E's primary concern was its investment and that a modification of the contract for Sierra's benefit would be justified under any circumstance where PG&E's investment was protected. If Sierra's president had exhibited the same reasonable attitude which he expected from PG&E in 1948 toward PG&E in 1952 when requested to renegotiate the present rate in accordance with the order of the California Commission[35] this proceeding would doubtless have been unnecessary.

In the present proceeding in 1953 Sierra's president testified that in his 1948 testimony before the California Commission he gave all the reasons which he could think of in support of the contract. The transcript of that proceeding will be scanned in vain for any indication that PG&E intended to give up any right to initiate a rate increase or that Sierra ever had any such understanding. Are we to

33. The context requires insertion of the "not" at this point.

34. R. 216.

35. R. 61, 283, 285.

believe now that it was mere oversight that when the 15-year term was mentioned in 1948, Sierra's president thought only of a proper return for PG&E's investment rather than a guaranteed rate for Sierra, even though he was obviously looking for reasons to satisfy his Nevada opposition?

Not quite two years later, before the California Commission in 1950, Mr. Moulton, PG&E's vice president and executive engineer, explained the difference between the 15-year term of the Sierra contract and the 5-year term of other resale contracts as follows:

> "We finally made a 15-year contract with Sierra Pacific. *We made a longer contract because we under-*[took][36] *to build an additional line* to supply them and *we felt we needed that protection of a long contract.*"[37]

Even in 1952, after Sierra had determined to oppose any increase by PG&E, Sierra's president before the California Commission on cross examination testified as follows:

> "Q. Is it not a fact, Mr. Tracy, that Pacific Gas and Electric Company was insisting on a 15-year contract in order to protect it in a very large investment that it had to make in facilities in order to bring power to the summit to supply to the Sierra Power Company?
>
> A. I think that works both ways. Yes, our company wished to have a firm contract too to cover our investment." (Ex. 23, pp. 1418, 1419)

36. The text has "understood" at this point, clearly a reporter's error.

37. R. 273. Emphasis supplied. This testimony also shows that Sierra is completely mistaken in interpreting Mr. Moulton's testimony as support for its position that the contract rate could not be changed. Mr. Moulton recognizes that the purpose of the 15 year term was to protect the new investment. This testimony was given within a few months after initiation of service over the new 110,000 volt line to Sierra, and the fact that an increase was not deemed warranted at that time does not constitute a bar to an increase under conditions of greatly increased cost.

In the same proceeding Sierra's president also testified as follows:

> "Q. Now do you have any question in your own mind as to the right of this Commission to change or modify the terms of contracts made between a public utility and one of its customers?
>
> A. It is my understanding that the Commission has jurisdiction over rates, yes, sir.
>
> Mr. Orrick. I didn't hear that answer. Would you read that back, please? (Record read.)
>
> Mr. Duval. In having jurisdiction over rates, it can increase or decrease the rates, would you agree with that?
>
> A. I presume that."[38]

Protection of investment is not accomplished by ignoring diminishing returns. Failure to allow a fair return on property devoted to public utility service is confiscation of that property. To argue that PG&E consented to possible loss of all return for up to 30 years on a new investment in excess of one million dollars is absurd and contrary to the express testimony.

J. The Adoption of Schedule P-31 Charges Does Not Support Sierra's Contention That the Rate Was to Be Fixed for the Contract Term.

When the present contract was being negotiated with Sierra in 1947 and 1948 PG&E had on file with the California Commission two tariffs of general application for intra-state resale electric service to customers who purchased all of their energy requirements from PG&E. One of these, Schedule P-31,[39] offered a rate approximately 10% below the other to resale customers who would enter into a five year contract for service. The contract with Sierra did

38. R 329.

39. R 299.

not incorporate the P-31 rate as such. It simply provided a schedule of demand and energy charges equivalent to those in effect under the P-31 tariff, plus a stand-by charge, and incorporated certain of the conditions of that tariff.

Sierra would argue first that the P-31 rate was established as a fixed rate for the term of each five-year contract and therefore that the Sierra rate is a fixed rate for the 15 to 30 year term of its contract. We have already shown that the conclusion does not follow because the 15 year term was proposed for protection of the new investment long before the P-31 rate entered into the negotiations. The premise that the P-31 rate could not be changed is equally unsound.

The California Commission has twice increased the P-31 rate since its adoption in 1945. The first occasion was in 1950 in response to PG&E's application for a 6% rate increase. The second occasion was in 1952 when the California Commission superseded Schedule P-31 by Schedule R, which is equivalent to the rate proposed in this proceeding. In each of those cases the Commission excepted from the increase certain named customers but the balance were required to pay the increased rate beginning with the effective date of the general increase regardless of the fact that they were being served under term contracts.[39a] This is

39a. As to the 1950 increase of 6%, Exhibit 18 shows that Pacific requested an increase in each of its filed schedules and was authorized to make such increase effective for service from April 15, 1950 subject only to the named exceptions. Pacific estimated that it would receive additional revenue of $140,000 annually from resale customers as a result of this increase.

As to the 1952 increase, Exhibit 17 shows that the California Commission authorized cancellation of all existing schedules and transfer of customers to the increased schedules applicable to the service rendered, including Schedule R for resale customers subject only to exception for certain listed contracts.

The exception of Sierra from the 1952 increase was expressly

convincing evidence that the California Commission does not regard the P-31 rate as immune from changes when required by increases in the cost level.

The testimony of PG&E's rate engineer in 1945, to the effect that users of the P-31 rate were assured of the lower rate for a five-year term (quoted by Sierra in its brief at pp. 31, 49), sounds impressive when isolated from its context. We believe, however, that a study of the record of that proceeding will show that Mr. Beckett meant "lower than the P-6 resale schedule" and that he did not have in mind a fixed rate regardless of cost considerations. In any event the California Commission has set the matter at rest by granting the increases above described.

K. Sierra Did Not Negotiate on the Basis That an Alternative Source of Power Was Actually Available.

Sierra never did act like a buyer playing one competitor against another. In October of 1947, Sierra's president explained to PG&E that his company was not prepared to continue negotiations, that there was local political pressure to bring Shasta power into Nevada which *hampered Sierra's* negotiation, and that Sierra could not afford to offend Shasta power advocates.[40] It is evident that PG&E was not given the impression that Sierra found anything desirable in the proposal for Bureau power. Instead, Sierra was making it clear that it was faced with public pressure urging "cheap" government power and ignoring the practical re-

stated by the California Commission to be for the purpose of allowing an opportunity for the parties to renegotiate the contract "in the light of the new basic resale schedule," i.e. Schedule R (Ex. 17, p. 41). The refusal of Sierra to negotiate (T. 988) does not convert this exception into a final disposition of the matter by the California Commission. The matter is pending before that Commission in a new proceeding.

40. R. 340.

quirements of the situation. The following testimony given by Sierra's president in this proceeding illustrates this point:

> "Q. Mr. Tracy, when Pacific Gas and Electric gave up the fuel escalator clause and submitted the proposed form of contract to you after the agreement on the demand and energy charge, what was your opinion as to why they were willing to give up that clause, which would have tended to protect them against at least one of the larger elements of risk in so long a term contract?
>
> [Objection by Mr. Searls on ground of irrelevancy overruled]
>
> . . . . . .
>
> A. They did not inform me as to the reason and I certainly would not take it upon myself to guess.
>
> By Mr. Wahrenbrock. Q. Did you think you had outsmarted them on that?
>
> A. No. That isn't the correct answer. We thought that we had showed them sufficient reasons for proposing to us a lower rate.
>
> Q. Namely the threat of taking your load some place else.
>
> A. The potential competition that was *very prevalent. The papers were full of it.* As I testified before, all the groups were active. The Chamber of Commerce had a power committee."[41]

Notice that Mr. Tracy declined to state that he threatened to take his load elsewhere. To him the word "competition" seems to be synonymous with "public pressure" since he stated in his testimony that even after the contract with PG&E was signed and approved by the California Commission, he was bothered by "competition".[42]

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41. Transcript, pp. 937, 938 (not printed).

42. R. 54.

In the face of all this evidence, which boils down to the fact that Sierra could not get the power it needed except from PG&E and the fact that any alternative was bound in the long run to mean high but uncertain costs when all factors were taken into account, Sierra's argument that it gave up a bargaining position or that either it or its customers have lost anything by making a contract with PG&E for service at a rate subject to regulatory change is without foundation.

"The papers were full" of competition and it was "very prevalent," but this sort of competition was more of a problem to Sierra than to PG&E. Sierra had no illusions about the desirability of a contract for Bureau power as is demonstrated by the intra-company communications which list Mr. Devore's or Mr. Tracy's objections to such an arrangement.[43]

Sierra was not making fine calculations to determine the cost of various alternatives nor was it trying to extract from PG&E an agreement for an unchangeable rate. The 15-year term was important from the investment standpoint. Sierra endeavored to and did obtain the lowest available rate from PG&E but this was a standard rate, available to qualified resale customers whether or not they had competitive sources of supply.

PG&E undoubtedly felt the effect of the public pressure and concluded that it should offer its standard resale rate, the P-31 tariff, but if did not expect that this rate would be fixed in the face of cost changes.

When called upon at the California hearing in 1948 to justify making the contract with PG&E, Mr. Tracy attempted to educate the public representatives from Nevada to the facts of the situation which Sierra then faced. He

43. R. 347-348, 350-351, 353-355.

showed that he really had no choice in the matter. He did not claim that the 15-year term was agreed upon to secure a favorable rate; he explained that it was a necessary protection for the new investments to be made. The public representatives were satisfied with this and withdrew their opposition.

In a few words, neither Sierra nor public opinion were demanding a fixed rate, nothing in the situation required a fixed rate and nothing in the negotiations, the contract, or the explanations of the contract in the 1948 proceeding ever suggested that a fixed rate had been discussed, much less agreed upon.

CONCLUSION

PG&E's rate for service to Sierra is just and reasonable by the standards of the Commission applied in accordance with the express terms of the Federal Power Act. Sierra's argument for a different procedure and a different result deprives the Commission of a major part of its function as an expert body in the field of rate regulation. In this particular case no fact exists which justifies a court of law in setting aside the Commission's determination, made only after Sierra was given a full and fair hearing. The order of the Court below should be reversed and the Commission's order affirmed.

Dated: November 4, 1955.

Respectfully submitted,

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